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Revenue Review

REVENUE ... Working For You

Tennessee Department of Revenue

October 2008

Contents:

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2008 Legislative Summaries

The following are a selection of 2008 legislative changes to statutes administered by or affecting the Tennessee Department of Revenue. For a complete copy of a particular public chapter, please visit the Secretary of State's Web site at www.state.tn.us/sos. View a list of legislative changes, including motor vehicle title and registration information, at the department's Web site, www.Tennessee.gov/revenue. Upcoming notices and other information about these changes are also posted online.

I. Sales and Use Tax

➢ **Kerosene Exemption**
Public Chapter 1106, Section 12, provides that kerosene sold at retail through dispensers that prevent delivery directly from the dispenser into a vehicle fuel supply tank (through a "blocked pump") is exempt from the sales and use tax. *Effective date: June 5, 2008.*

➢ **Fundraising by Library Support Organizations**
Public Chapter 1106, Section 11, amends the exemption for fundraising activities by charitable organizations whose primary purpose is fundraising in support of a city, county or metropolitan library system. The organization may elect to make sales on a continuous basis rather than being limited to two semiannual temporary sales periods. A continuous sale shall be exempt, provided that sales do not exceed $100,000 per calendar year. The election must remain in effect for at least four years. *Effective date: January 1, 2009.*

➢ **Electronic Filing**
Public Chapter 1106, Section 32, provides that a taxpayer who is required to file sales and use tax returns electronically for any one outlet, location or other place of business may be required to file returns electronically for each location. *Effective date: June 5, 2008.*

➢ **Qualified Data Centers: Computer Exemption**
Public Chapter 1106, Section 25, provides that the exemption for computers, computer networks and computer software used in a qualified data center includes warranty or service contracts for such equipment. *Effective date: June 5, 2008.*

➢ **Qualified Data Centers: Investment Period**
Public Chapter 1106, Section 26, provides that the Commissioner of Economic and Community Development may extend, for a reasonable period not to exceed two years, the period during which a data center must invest $250 million in order to qualify for certain tax incentives. *Effective date: June 5, 2008.*

➢ **Sales and Use Tax Compliance Agreements: Tax Credits**
Public Chapter 1106, Sections 27-28, authorizes the Commissioner of Revenue to enter into managed compliance agreements with taxpayers in order to facilitate the calculation of the qualified headquarters facility, emerging industry or major cultural attraction credits. For these purposes, an eligible taxpayer is one who has qualified to receive the credit, demonstrates a willingness and ability to comply with the tax laws of this state, maintains an acceptable system of internal controls and business records, and cooperates with Tennessee's efforts to collect tax. In addition, "managed compliance agreement" is defined as an agreement between the Commissioner and an eligible taxpayer that provides for an agreed upon method for calculating the credit due. *Effective date: June 5, 2008.*

➢ **Specified Digital Products: Definitions**
Public Chapter 1106, Section 18, clarifies the application of the sales and use tax to music, books and video that are downloaded digitally rather than purchased in their traditional form. The clarification is accomplished through the implementation of various definitions relating to digital products in compliance with the Streamlined Sales and Use Tax Agreement. *Effective date: January 1, 2009.*

➢ **Sales of Specified Digital Products**
Public Chapter 1106, Section 19, provides that the retail sale, lease, licensing or use of specified digital products transferred to or accessed by subscribers or consumers in Tennessee are subject to sales and use tax. Retail sales, leases, licensing or use subject to tax includes specified digital products sold both with rights of permanent and less than permanent use; those sold with rights of use conditioned on continued payment by the subscriber or purchaser; and subscriptions to, access to or the purchase of a digital code for receiving or accessing specified digital products. However, "digital code" does not include gift certificates or gift cards that represent a monetary value that is redeemable for specified digital goods. In addition, subscriptions to satellite radio services are excluded from "specified digital products" subject to tax. Subscriptions to data processing and information services that allow data to be generated, acquired, stored, processed or retrieved and delivered by electronic transmission to a purchaser are also excluded from taxable "specified digital products" when the purchaser's primary purpose for the transaction is the processed data or information. *Effective date: January 1, 2009.*

➢ **Specified Digital Products: Exemptions**
Public Chapter 1106, Section 20, provides that the tax on retail sales of digital products does not apply when the equivalent product in tangible form is exempt from sales and use tax. Digital music, digital books and digital videos

provided to the customer without charge on a trial basis are also exempt from tax. *Effective date: January 1, 2009.*

- **Specified Digital Products: Standard Local Rate**

Public Chapter 1106, Section 21, implements a standard local tax rate of 2.5 percent with respect to sales of specified digital products. *Effective date: January 1, 2009.*

- **Specified Digital Products: Industrial Machinery Exemption**

Public Chapter 1106, Section 22, provides an exemption for machinery and equipment necessary to convert tangible personal property into taxable specified digital products for resale and consumption off the premises. *Effective date: January 1, 2009.*

- **Farming Exemption**

Public Chapter 1106, Section 23, clarifies that persons in the business of producing *and* selling agricultural products qualify for the exemptions afforded to a "qualified farmer or nurseryman." *Effective date: June 5, 2008.*

- **Membership Dues**

Public Chapter 1106, Sections 2 and 3, repeals the sales tax exemption applicable to the first $150 per year of membership dues or fees to a recreation club or community service organization. Pursuant to 2007 Public Chapter 602, Section 152, this exemption was originally repealed effective July 1, 2009. Public Chapter 1106 revises the date of repeal, making it effective July 1, 2008. *Effective date: Applies to dues and fees billed on or after July 1, 2008 for membership periods occurring on or after July 1, 2008.*

- **Repair and Maintenance of Medical Equipment**

Public Chapter 1106, Section 7, clarifies that the repair of tax-exempt medical equipment is exempt from the sales and use tax. In addition, components or attachments for single-patient use in conjunction with oxygen delivery equipment, kidney dialysis equipment and enteral feeding systems are exempt. *Effective date: June 5, 2008.*

- **Home Health Care Providers**

Public Chapter 1106, Section 8, clarifies language applicable to tangible personal property that is subject to sales and use tax when purchased for use in providing outpatient health care services in the home. Such property subject to tax includes mobility enhancing equipment and durable medical equipment, except that oxygen delivery equipment, kidney dialysis equipment and enteral feeding systems continue to be fully exempt from tax regardless of the purchaser. *Effective date: June 5, 2008.*

- **Durable Medical Equipment**

Public Chapter 1106, Section 9, provides that the term "durable medical equipment" includes repair and replacement parts for the equipment unless the repair or replacement part is a part, component or attachment that is for single patient use. *Effective date: June 5, 2008.*

II. Franchise and Excise Tax

- **Job Tax Credit: Economically Distressed Counties**

Public Chapter 1106, Section 47, allows qualified business enterprises located in tier two or tier three economically distressed counties additional time (three and five years, respectively) to create the minimum number of jobs necessary to receive the job tax credit. *Effective date: June 5, 2008.*

- **Job Tax Credit: Newly Created Positions**

Public Chapter 1106, Section 48, authorizes the Commissioner of Revenue, with the approval of the Commissioner of Economic and Community Development, to approve a job tax credit where the newly created position existed in Tennessee less than 90 days prior to being filled by the taxpayer, provided that the allowance of the credit is determined to be in the best interests of the state. *Effective date: June 5, 2008.*

- **Job Tax Credit: Extension of Investment Period**

Public Chapter 1106, Section 44, authorizes the Commissioner of Economic and Community Development to extend, by up to four years, the period during which a qualified business enterprise must make the required capital investment in excess of one billion dollars in order to qualify for the job tax "super credit." *Effective date: June 5, 2008.*

- **Net Operating Loss Carryforward**

Public Chapter 1106, Section 43, authorizes the Commissioner of Revenue and the Commissioner of Economic and Community Development to allow a taxpayer that qualifies for the job tax credit under § 67-4-2109(c)(2)(I)(i), (ii) or (iii), to carry net operating losses forward beyond the initial 15-year authorized period, provided that such an extension is determined to be in the best interests of the state. *Effective date: June 5, 2008.*

- **Job Tax Credit: Sunset**

Public Chapter 1106, Section 42, moves the job tax credit sunset date from January 1, 2011 to January 1, 2016. *Effective date: June 5, 2008.*

- **Family-Owned Non-corporate Entity Exemption**

Public Chapter 1106, Section 68, requires every exempt family-owned non-corporate entity (FONCE) to file forms periodically reporting such information as the Commissioner of Revenue shall reasonably prescribe regarding the family-owned non-corporate entity and the family members participating therein. No later than January 20, 2009, the Commissioner must submit to the General Assembly a summary report of the compiled information. The report must include an analysis of the utilization, costs and benefits of the exemption as well as findings and recommendations pertaining to continuation of the exemption. *Effective date: June 5, 2008.*

- **Captive Real Estate Investment Trusts: Definition**

Public Chapter 1106, Section 35, defines the new term "captive real estate investment trust" or "captive REIT" to mean "an entity with an election in effect under § 856(c)(1) of the Internal Revenue Code in which the taxpayer, directly or indirectly, has at least 90 percent ownership interest by value determined in accordance with generally accepted accounting principles and whose shares are not traded on a national stock exchange." *Effective date: Applies to all tax periods ending on or after July 1, 2008.*

- **Captive Real Estate Investment Trusts: Net Earnings**

Public Chapter 1106, Section 36, requires financial institutions to disclose dividends received from captive REITs. Failure to make such disclosures will result in a disallowance of the deduction for dividends received by financial institutions that own 80 percent or more of the outstanding capital stock of a captive REIT. Failure to disclose will also result in a 50 percent penalty on the amount of any underpayment arising from the adjustment to the financial institution's net earnings. *Effective date: Applies to all tax periods ending on or after July 1, 2008.*

➢ **Sales by Affiliates**
Public Chapter 1106, Section 37, levies the excise tax on any gain from the sale of an asset by an entity not otherwise subject to the excise tax if the asset was owned during the 12-month period immediately prior to the sale by an affiliate that was subject to the excise tax at the time of ownership but ceased to exist before the sale occurred. *Effective date: Applies to all transactions occurring on or after July 1, 2008.*

➢ **Diversified Investing Funds Exemption**
Public Chapter 1106, Section 41, clarifies the scope of the exemption for diversified investing funds. A fund will not qualify for the exemption if its capital is derived primarily from entities or individuals who are affiliated with the fund. This public chapter provides that the term "affiliated" includes individuals who have more than 50 percent ownership in the fund, including indirect ownership through a family member (ancestors; spouses or former spouses; lineal descendents of the individual, spouse, former spouse or parents; spouses or former spouses of lineal descendents; estates or trusts of deceased individuals who, while living, were any of the above). *Effective date: Applies to any tax period beginning on or after January 1, 2009.*

➢ **Phase-Out of Deduction for Financial Institution Affiliated Groups**
Public Chapter 1106, Section 53, eliminates, over a period of four years, the 25 percent deduction that has been allowed in computing net worth for financial institution affiliated groups that elect to compute their net worth on a consolidated basis. For tax years beginning on or after January 1, 2008, the financial institution affiliated group may deduct 20 percent of its securities classified as held to maturity or available for sale. For tax years beginning on or after January 1, 2009, the deduction is changed to 12.5 percent; for tax years beginning on or after January 1, 2010, the deduction is changed to 5 percent; for tax years beginning on or after January 1, 2011, the deduction is eliminated entirely. *Effective date: June 5, 2008.*

III. Other Taxes

➢ **Gasoline Tax**
Public Chapter 1106, Section 40, suspends until July 1, 2009 the required increase in the Tennessee gasoline tax by an amount equal to any decrease in the corresponding federal tax. *Effective date: June 5, 2008.*

➢ **Estate and Inheritance Taxes: Refund Claims**
Public Chapter 1106, Section 34, clarifies that the Commissioner of Revenue is authorized to refund estate and inheritance tax due a taxpayer because of a decrease in federal estate tax resulting from an examination by the Internal Revenue Service, provided that the claim is filed with the Commissioner within two years from the date of the redetermination of the estate. *Effective date: June 5, 2008.*

➢ **Estate or Inheritance Taxes: Assessments**
Public Chapter 1106, Section 33, clarifies that the statutory period during which the department can make an assessment of estate or inheritance tax as a result of a federal estate tax adjustment made by the Internal Revenue Service shall not expire prior to the expiration of two years from the date the Commissioner is notified in writing by the taxpayer of such revisions. *Effective date: June 5, 2008.*

➢ **Business Tax**
Public Chapter 1100 allows the county clerk or city tax collector to collect delinquent business tax at any time before the Commissioner of Revenue notifies the taxpayer of an audit or takes any other action to collect the tax under the provisions of the Tax Enforcement Procedures Act. The Commissioner cannot begin collection until the tax has been delinquent for more than six months. *Effective date: June 5, 2008.*

➢ **Business Tax**
Public Chapter 924 raises, from $3.50 to $5, the fee due the county clerk for transferring a business license from one location to another. *Effective date: July 1, 2008.*

IV. Miscellaneous Tax-Related Legislation

➢ **Grace Period for Filing of Tax Documents**
Public Chapter 1106, Section 1, makes the 24-hour grace period for filing tax documents applicable to documents sent via delivery services, in addition to those sent via United States Mail. Prior to this amendment, the 24-hour grace period only applied to documents transmitted via United States mail. *Effective date: June 5, 2008, and shall apply to matters under appeal on the effective date.*

➢ **Attorneys' Fees**
Public Chapter 1106, Section 60, provides that any party that is found to have committed fraud or to be the transferee of assets conveyed in violation of the provisions of Title 66, Chapter 3, relating to fraudulent transfers of property, shall not be awarded attorneys' fees or litigation expenses. *Effective date: June 5, 2008.*

➢ **Tobacco Licenses**
Public Chapter 1090 requires that an application for a tobacco license include the applicant's telephone number as well as the name, address and telephone number of the resident agent (in addition to information that is already required on the form). The chapter also provides that all licensees must notify the Commissioner of Revenue, in writing, within 10 days of any change in the information provided on the application. The chapter also increases the license fee for manufacturing distributors, tobacco manufacturer's warehouses and wholesale dealers and jobbers from $20 to $200. It increases the license fee for tobacco distributors from $10 to $100 and raises the fee for replacement of a lost or destroyed license from $1 to $25. The chapter further provides that a tobacco license renewal may be denied for failure to pay the tobacco tax or for violation of any other provision of title 67, chapter 4, part 10. Finally, the chapter increases the specific penalty for engaging in business without obtaining or renewing the required license. The penalty is increased from 50 percent to 100 percent of the license fee for each month or part of a month during which the activity continues. (The Commissioner of Revenue also has the discretion to impose an additional penalty of up to $250 per day for each day the unauthorized activity continues.) *Effective date: July 1, 2008.*

Ruling Preserves Tennessee's Income Tax

On May 19, 2008, the United States Supreme Court issued a decision in a case that had a potential impact on the Tennessee individual income tax. The case, Department of Revenue of Kentucky v. Davis, 128 S.Ct. 1801 (2008), involved the taxation by Kentucky of income from state and municipal bonds.

Kentucky exempts from its state income tax the interest on bonds issued by it or its political subdivisions; no similar exemption exists for income on bonds issued by other states and their subdivisions. Tennessee also uses this approach in its individual income tax, also known as the "Hall" tax. The reason for this type of exemption is that state and municipal bonds generally pay a lower interest rate than other bonds with the same type of risks; therefore, the state must offer some incentive in order for these bonds to be attractive.

The taxpayers in the Davis case sued the Kentucky Department of Revenue, claiming that Kentucky's differential taxation of municipal bond income discriminated against interstate commerce in violation of the Commerce Clause of the United States Constitution. The United States Supreme Court held that an exception to the Commerce Clause exists when states are acting as "market participants." In other words, when a state goes beyond regulating the market and begins participating in a market, it has the right to favor its own citizens over the citizens of other states. Therefore, Kentucky's imposition of a differential tax scheme did not violate the Commerce Clause because Kentucky was acting as a bond issuer participating in the bond market.

The Supreme Court's decision permits Tennessee to continue to provide an exemption from the individual income tax for bonds issued by Tennessee and its counties and municipalities.

Learn more about Tennessee's individual income tax online, including due dates, online filing options and more, at www.Tennessee.gov/revenue.

Tennessee Shines in Economic Development

On May 1, Revenue Commissioner Reagan Farr joined Governor Phil Bredesen and Economic and Community Development Commissioner Matt Kisber in accepting the 2007 Competitiveness Award from *Site Selection* magazine. This leading economic development magazine ranked Tennessee as #1 in the U.S. for its competitiveness in economic development.

Commissioner Kisber, Governor Bredesen and Commissioner Farr appear at a press conference on Volkswagen's decision to move its U.S. manufacturing operations to Tennessee.

Consistently updating legislation to suit a variety of businesses, reforming workers' compensation, exercising sound fiscal management and establishing connectedness between various state agencies through the Jobs Cabinet helped Tennessee achieve the top spot.

As a reflection of his priority to move more jobs to Tennessee, Governor Bredesen created the Jobs Cabinet shortly after his 2003 inauguration. Created by Executive Order, the Jobs Cabinet facilitates cooperation between the various departments of state government concerned with the creation of better paying, higher skilled jobs.

A key example of the state's dedication to bringing industry and jobs to Tennessee is the July 15 announcement that Volkswagen Group of America, Inc. will locate its U.S. manufacturing operations in Chattanooga. Tennessee beat out Alabama and Michigan because of its strong workforce, training opportunities and support by the state to facilitate the move.

Shortly after, Nissan Americas celebrated the dedication of its headquarters in Franklin on July 22. The new center serves as the regional headquarters for the United States, Canada and Mexico. Tennessee was selected by Nissan in 2005, an early indication of the state's ability to move jobs and industry here.

Incentives are available for various-sized companies to locate or expand in Tennessee. To learn more about what's offered, please visit the online Tool Kit at www.Tennessee.gov/ecd.

Save the Date: Upcoming New Business Workshops

Nov. 7 – Knoxville, 8:30 a.m. to 12:30 p.m.
Nov. 8 – Johnson City, 8:30 a.m. to 11:45 a.m.
Nov. 8 – Memphis, 9 a.m. to noon
Nov. 14 – Chattanooga, 8:30 a.m. to 1:15 p.m.
Nov. 27 – Nashville, 9 a.m. to 1:30 p.m.
Visit www.Tennessee.gov/revenue to register or learn more.

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- Streamlined Sales Tax hot line: Statewide toll-free (877) 250-2299; Nashville-area and out-of-state callers, dial (615) 253-0752
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